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C O N F I D E N T I A L SECTION 01 OF 03 TAIPEI 000136

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TAGS: ECON ETRD EINV PREL CH TW
SUBJECT: STEEL AND CEMENT - DEEPENING CROSS-STRAIT ECONOMIC INTEGRATION?

REF: 04 TAIPEI 3406

Classified By: AIT Director Douglas H. Paal, Reason 1.4 (b/d)

Summary

¶1. (C) Taiwan,s steel industry is exporting a large portion of its output to the PRC, accounting for as much as 50 percent of Taiwan,s steel exports. As is the case for many other Taiwan exports to the Mainland, Taiwan steel is mainly used to manufacture consumer goods for re-export to markets in the U.S., Japan and Europe. However, Taiwan,s cement industry is investing in Mainland manufacturing facilities aimed at taking advantage of the PRC,s growing domestic cement market. As much as 25 percent of the output of Taiwan,s cement firms is produced in the Mainland, primarily for use in the PRC. Taiwan,s cement industry is currently one exception, and more industries will likely follow and come to increasingly rely on the internal PRC market to purchase Taiwan exports and the output of Taiwan-owned manufacturing facilities in the PRC. More profound economic integration will increase Taiwan,s exposure to fluctuations in the PRC economy and may further raise the price of each side,s efforts to apply pressure across the Strait. (End summary.)

¶2. (U) Most of Taiwan,s investment in Mainland China has been aimed at the export market. First labor-intensive manufacturing of consumer goods like apparel, shoes, and toys moved production to China followed by high-tech manufacturers of electronic goods. Both were aimed at producing consumer goods for export to the U.S., Japan and Europe. This kind of investment has also driven Taiwan,s trade with the Mainland. High-tech components sold to Taiwan firms manufacturing electronic consumer goods in the PRC dominate cross-Strait trade accounting for more than half of Taiwan,s exports to the Mainland.

¶3. (U) Taiwan,s steel industry fits this pattern of trade flow. Cross-Strait investment in the steel industry has been small, but Taiwan exports a large proportion of its steel output to the Mainland. As much as 90 percent is then exported again after processing into finished consumer goods. However, a different phenomenon is taking place in the cement industry. Taiwan cement firms are investing significant amounts in Mainland China but not to take advantage of China,s cheap labor to produce goods for the U.S., European and Japanese markets. Instead, cement industry investors seek to tap growing domestic demand in the PRC.

Steel Trade) Targeting the High-End Market

¶4. (SBU) The PRC is a net steel exporter, but most of the exports are low-quality, upstream steel, allowing Taiwan the opportunity to continue exporting its high-quality downstream steel products, such as cold-rolled steel, silicon steel, and galvanized sheets. Y.S. Chen, Assistant Vice President at China Steel, Taiwan,s largest steel producer accounting for about 10 million metric tons of Taiwan,s 17 million MT total output, told AIT/T that 10 percent of China Steel,s total production is exported to the PRC. He also estimated that up to 15 percent of the output that China Steel sells within Taiwan is further processed on the island and then exported to the PRC in products such as bolts, nuts, and hand tools. Wu Sheng-feng, General Secretary of the Taiwan Steel and Iron Industries Association (TSIIA) told us that approximately 50 percent of Taiwan,s steel exports go to Mainland China. He estimates that 80 to 90 percent of Taiwan,s steel is then used to produce PRC exports. According to Yieh Phui Steel,s President Wu Lin-maw, his firm,s exports to the PRC accounted for 50 percent of its total output. Twenty-five percent of output was sold to Hon Hai Precision, Taiwan,s largest company by revenue, which uses the galvanized steel to produce its computer cases.

Steel Investment) Strategic Disadvantages

¶5. (SBU) Although Taiwan,s steel exports to the Mainland are

considerable, investment has remained relatively small. TSIIA,s Wu told us that six of the association,s members

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have invested in the Mainland, mainly focusing on downstream processes, like cutting and galvanizing. Chen of China Steel, which has not invested in the PRC, explained that investing in the PRC would be more attractive if Taiwan firms could build a vertically integrated mill, allowing them to produce their own high-grade inputs for downstream products. However, Chen argued that the PRC wouldn,t approve investment licenses for upstream steel production. In addition, cross-Strait shipping costs are low enough (reftel) to keep Taiwan steel exports competitive in the Mainland market. Yang Chiu-yueh, managing director of Kao Hsing Chang (KHC) Iron and Steel, pointed out that the cost of shipping one ton of steel to the PRC was as low as USD 13, while the cost of shipping one ton from Taiwan,s steel production center of Kaohsiung to Taipei was USD 15. In October 2001, KHC initiated plans to build a steel pipe producing plant through a joint venture with China Petroleum and Natural Gas in the PRC. However, KHC has suspended the project primarily because it has been unable to get enough high-quality steel inputs.

Cement Investment - Cleaner, More Efficient, Higher Quality
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¶6. (U) Taiwan,s cement industry has taken a different direction with relatively high-levels of investment in the PRC aimed at supplying domestic PRC demand. Chia-Hsin Cement was the first Taiwan firm to invest in Mainland China. It first entered the Mainland cement market in 1993 and began production at its first plant in 1998. Today there are four firms with eight cement production plants in the PRC. Most are located in the Yangtze River Delta area. Hsing Ta Cement is preparing to become the fifth Taiwan firm to invest in the Mainland. Nearly 25 percent of cement produced by Taiwan firms is produced in the PRC.

¶7. (SBU) Despite administrative control measures designed to slow growth, the PRC has approved new investment proposals for Taiwan cement firms. Taiwan firms offer production that is more environmentally sound. According to Hsing Ta Cement Chairman John Yang, much of the PRC,s cement is produced with limestone mined by individuals who use excessive quantities of dynamite to recklessly blow holes in hillsides with rich deposits. This technique is inefficient, produces large amounts of air pollution and makes it difficult to repair the damaged landscape. In addition, Taiwan firms produce a higher grade of cement than local PRC producers. As Yang explained, the PRC has three grades of cement. Most countries and Taiwan have only one grade, which is roughly the same as the highest grade in the PRC. Demand for higher-grade cement has the strongest potential for long-term growth.

Cement Investment - Different Strategies

¶8. (SBU) Different Taiwan cement firms have pursued different strategies in their Mainland investments but in the end all have focused on the domestic PRC market. Chia Hsin Cement Greater China Holding Corp CEO Jason Chang told AIT/T that its original purpose in investing in the Mainland was to supply the Taiwan cement market. Chang said that after Taiwan began restricting mining rights on Taiwan,s west coast in the early 1990s, Chia Hsin calculated that basing operations on Taiwan,s east coast would be unprofitable and looked to coastal locations in the Mainland to supply Taiwan,s market. Chia Hsin abandoned cement production in Taiwan entirely. In its first year of production, nearly 80 percent of production from Chia Hsin,s Zhejiang plant was exported to Taiwan. After the Asian financial crisis pushed down cement prices in the region by more than 50 percent, Chia Hsin began selling more to the domestic PRC market. By 2003 all of the plant,s output was consumed in the PRC. With cement prices in the PRC dropping, Chang says the firm will export approximately 40 percent of output in 2005.

¶9. (SBU) Citing transportation costs, Hsing Ta,s Yang dismisses exporting entirely as a viable option for cement except to dispose of excess supply. Hsing Ta is looking to establish a plant in a location where it can take advantage of strong existing demand or capitalize on future growth. According to Yang, Hsing Ta is considering sites in Wuhan, Nanjing, or Yunnan province. Although Hsing Ta expects that up to 60 percent of its customers would be Taiwan firms, including Taiwan ready-mix cement producers, only minimal output would be exported from the PRC.

Cement - Lower Prices and Long-Run Growth

¶10. (SBU) Taiwan cement firms and industry observers believe that the PRC,s macro-economic control measures have had a

substantial impact on the Mainland cement market, but long-term potential for demand growth justifies further investment particularly as Taiwan,s cement demand has fallen. According to Christopher Pei, Secretary General of the Taiwan Cement Manufacturers, Association, demand in Taiwan reached its peak in 1993 at 1,332 kg per capita. By 2003, per capita demand had fallen to 657 kg. In comparison, PRC per capita demand is only 300-400 kg leaving much potential for growth. Chia Hsin,s Chang told AIT/T that currently the domestic cement market in China is not only affected by macro-economic controls, but is also in a cyclical downturn as the PRC nears the end of the Tenth Five-Year Plan. He expects a strong rebound beginning in 2006 after cement industry consolidation in 2004 and 2005.

Comment) Increasing Economic Integration?

¶11. (C) Cement and steel industry cross-Strait trade and investment show that Taiwan has been able to take advantage of its superior technical expertise to find market opportunities in the PRC, not only in the "high-tech" industries of information technology and electronics, but also in traditional heavy industries. Growth in cement industry cross-Strait investment also shows another trend)- a growing dependence on domestic demand in the PRC. Most Taiwan-owned firms in the Mainland manufacture goods for export to a third market, and the bulk of Taiwan's exports to the PRC provide inputs for those investments. This pattern has insulated Taiwan from fluctuations in the PRC economy. However, in the cement industry this pattern is not holding. Taiwan's cement producers rely increasingly on domestic PRC demand for continued profitability and growth. Other industries will eventually follow this trend. The PRC recently surpassed Japan as the number two market for computers in the world. Its domestic market will figure more and more heavily into the strategies of Taiwan's electronics and information technology firms, as well as other industries. This phenomenon will increase political pressure in favor of further cross-Strait economic liberalization from Taiwan firms that see the domestic PRC market as their best opportunity for future growth. With the increasing danger of harming domestic economic interests, Taiwan will find its options for applying economic pressure on the PRC will diminish. However, economic integration runs both ways. With the PRC's growth dramatically outstripping Taiwan's and investment and trade pouring in from other countries, more profound economic ties with Taiwan will help restrain the PRC's hand in dealing with the Taiwan question. (End comment.)
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